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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission

In the Matter of:

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)))	MM Docket No. 92-266
Rate Regulation and Leased Access Rates, Terms and Conditions	))	

To the Commission

JOINT COMMENTS

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<u>Summary</u>

These comments address the various proposals, tentative conclusions and questions set forth by the Commission in its rate regulation rulemaking. They begin with an overview of the principles that the Companies believe should be embodied in any rate regulation scheme adopted by the Commission.

The Companies concur that the 1992 Cable Act gives the Commission discretion in formulating and implementing rate regulations and that a properly structured benchmark approach meet the statutory requirements and objectives in a manner that is not unduly disruptive to the cable industry. Any system, including benchmarks, must, however, ensure that the cable operator has an opportunity to earn a fair return on investment, and, accordingly, the Companies suggest a simplified cost-based approach which takes into account annual cost increases for programming and in other areas which impact the cable industry.

The Companies also address other aspects of the proposed rate regulation process. They agree that franchising authorities may forbear from rate regulation; additionally, they urge that both basic rate increase applications and complaints against tier rates be acted on expeditiously; that a uniform rate structure does not preclude rational classifications and that promotional discounts or packages should not be deemed discriminatory. Finally, the Companies

propose a scheme for the regulation of leased channel rates, terms and conditions which takes into account the value of the channel.

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To the Commission

JOINT COMMENTS

Blade Communications, Inc., MultiVision Cable TV Corp., Providence Journal Company,[1] and Sammons Communications, Inc. (the "Companies"), by their attorneys, hereby submit their comments in response to the above-captioned Notice of Proposed Rulemaking. Each of the Companies is an owner and operator of cable television systems and will be directly affected by the outcome of this proceeding.

Section 3 of the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Act" or "Act") replaces Section 623 of the Cable Communications Policy Act of 1984 (the "1984 Act") in its entirety and directs the Commission to adopt new rate regulation rules for basic and tiered services for systems which are not subject to

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[1] Providence Journal Company conducts its cable television operations through its subsidiaries Colony Communications, Inc. and King Videocable Company.

effective competition as defined by the Act. These comments will highlight certain fundamental principles that should guide the Commission in its adoption of a rate regulation regime for basic and tiered services and associated equipment. The comments also suggest a form of cost based rate regulation for cable operators who believe that a benchmark approach does not adequately and equitably reflect an appropriate service rate for their particular operation and for adjustment of established benchmarks to reflect cost increases over time. The Companies also address equipment charges and suggest certain principles which should govern the regulation of these charges. Additionally, the comments respond to other important issues raised in the NPRM regarding the rate regulation process. Finally, the Companies offer proposals for the establishment of regulations and guidelines for leased access rates, terms and conditions.[2]

I. Rate Regulation

A. General Rate Regulation Principles

1. The Commission Has Discretion in Devising a Rate Regulation Process and Defining the Objective of That Process.

In its formulation of the rate regulation provisions of the 1992 Act, Congress had no predetermined view as to what any cable service should cost but intended only that the

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[2] As requested by note 193 of the NPRM, the Companies' discussion of leased access is contained in Section II of these comments.

Commission ensure that rates are reasonable; moreover, Congress deliberately chose not to impose a specific rate regulation methodology on the Commission. The legislative history of Section 3 clearly recognizes that the Commission is to have flexibility and discretion in fashioning a rate regulation regime and, in discussing the deletion of language which would have required the Commission to adopt a formula to determine a maximum rate, the conferees noted that the purpose of this change was

> . . . to give the Commission the authority to choose the best method of ensuring reasonable rates for the basic service tier and to encourage the Commission to simplify the regulatory process.[3]

Further guidance is provided by the Act's enumeration of various elements and factors which the Commission should take into account in formulating a process to achieve reasonable rates. As the Commission correctly observes in the NPRM, no one of these factors is to be given disproportionate weight; the Companies concur with this interpretation.

The Companies likewise concur with the Commission's tentative conclusion that a properly structured benchmark approach can achieve the goals of reasonable rates and ease of administration; as will be discussed hereinafter, however, the Companies submit that in order to satisfy legal

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[3] H.R. Conf. Rep. No. 862, 102d Cong., 2d Sess. 62 (1992).

requirements, to accomplish other policy objectives and to avoid unintended consequences, a benchmarking system must incorporate adequate safeguards to protect operators whose rates exceed the benchmark for valid reasons and to accommodate future changes and growth in the industry.

2. The Rate Regulation System Must Ensure That Cable Operators Have the Opportunity to Earn a Fair Return on Investment.

While the Act gives the Commission considerable discretion, its freedom to exercise that discretion is not absolute. In its selection of a rate regulation process to accomplish the goal of reasonable rates, the Commission is constrained by the well-established principle of regulatory law that a balance must be struck between reasonable rates and allowing a company to earn a sufficient return on investment to attract capital and thereby enable it to operate efficiently and offer additional or enhanced services.[4] Both Congress and the Commission have noted and commented favorably on the explosive growth in cable programming that has occurred since passage of the 1984 Act. While there may be differences of opinion as to the appropriateness of rates charged by certain operators, there can be no disagreement that significant programming advances would have occurred much more slowly, if at all, absent deregulation. Therein lies the dilemma inherent in this

[4] See, e.g., FPC v. Hope Natural Gas, 320 U.S. 591 (1944); NPRM at para. 94.

proceeding; in implementing the statutory commands of the 1992 Act, the Commission should proceed cautiously so as not to thwart the industry's ability or willingness to commit substantial investment in new services or facilities.

3. Each Level of Service Must Have the Opportunity to Earn a Fair Return.

As a corollary principle, each level of service offered by the cable operator must have the opportunity to earn a fair return and subscribers to each level of service should bear the appropriate costs associated with that level of service. The Companies submit that it would not be appropriate for the Commission to establish a scheme of regulatory cross-subsidies in an attempt to create an artificially low rate.[5] As the Commission is well aware, the rate regulation environment in effect prior to the 1984 Act effectively constrained the price of the regulated basic tier to unreasonable and unrealistic levels while forcing rate increases to be taken on higher levels of service; the revenues attributable to these rate increases from selected services were applied to operating costs and capital investment for the system as a whole. The resulting imbalance caused significant difficulties for program suppliers and for cable industry marketing efforts; the 1984

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[5] A rate regulation approach which affords preferential economic treatment to the basic service level consisting of statutorily mandated broadcast signals would exacerbate First Amendment concerns.

Act gave operators the much-needed ability to price their various service offerings more in keeping with subscribers' perceptions of their value. To reverse this process and return to a scheme which dictates price differentials among various levels of service that have no economically rational basis would have the same adverse effect on the cable operator's ability to market its services.

4. Rate Levels and Rate Structures for Premium Services Are Outside the Scope of the Act.

With the exception of the prohibition against requiring the purchase of any tier other than basic as a condition of access to premium (or a la carte) and pay-per-view programming, the 1992 Act clearly recognizes the long-standing proposition that premium and pay-per-view channels are not subject to rate regulation by federal or non-federal authorities. The Commission has declared premium services to be deregulated since the inception of its regulatory program for cable[6] and that judgment has been affirmed by the courts.[7] Moreover, the Commission has admonished regulatory officials that in exercising rate regulation power over basic, they may not indirectly exert authority or otherwise

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[6] Cable Television Report and Order, 36 FCC2d 141 (1972).

[7] Brookhaven Cable TV, Inc. v. Kelly, 573 F.2d 765 (2d Cir. 1978), cert. denied, 441 U.S. 904 (1979).

implicate premium services.[8] Congress has seen fit to not disturb this established policy.[9] Accordingly, the Commission should reaffirm that premium and pay-per-view services, including multiplexed and multi-pay discounted services, are exempt from direct or indirect regulation.

5. The Same Benchmark Approach Should Apply to All Regulated Levels of Service.

Section 623 of the 1992 Act assigns responsibility for the initial enforcement of the Commission's basic service regulations to franchising authorities; the Commission is given authority to regulate rates for cable programming services or tiers. As framed by the Act, the standard for basic service is "reasonable rates", whereas the standard for the Commission's review of tiers is "unreasonable rates". Notwithstanding these differences, the Companies believe that if the Commission is to adopt the benchmark approach, it should apply that concept consistently to all regulated levels of service. Doing so not only will make the regulatory scheme easier to administer, a result in keeping with the Act, but also will ensure the overall financial viability of the regulated cable system. If the same benchmark approach does not apply to all regulated levels of

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[8] Letter from David D. Kinley, Chief, Cable Television Bureau to Howard E. Hausman, Commissioner, Public Utilities Commission (Connecticut), June 25, 1975.

[9] The legislative history also acknowledges that multiplexed premium channels are exempt from regulation. H.R. Rep. No. 628, 102d Cong., 2d Sess. 80 (1992).

service, there is a potential that all elements of the benchmark mechanism will be rational for the particular level of service but will not, in the aggregate, for all levels of service equal the amount necessary to recover all costs, including the cost of capital.

The Companies agree, however, that the Act's use of the terms "reasonable" and "unreasonable" is intended to have meaning and suggest that Congress' concern regarding tiers primarily focuses on significant departures from the rate norm, or the "bad actor" category. While applying the same benchmark approach for both basic and tiers, the Commission could rationalize the difference in the regulatory standards by permitting a wider tolerance or deviation from the tier benchmark than from the basic benchmark.

B. <u>A Simplified Cost Based Alternative to Benchmarks.</u>

As the NPRM points out, a benchmark approach, however formulated, may not accurately apply to all systems; accordingly, it will be necessary to establish alternatives which will enable the operator to show that rates for a particular system are reasonable and justified. Additionally, some mechanism must be provided for adjustment of established benchmarks over time, both to take external costs into account and to incent operators to invest in services, facilities and equipment. The Companies suggest a simplified cost based approach as follows:

1. The Commission should determine the average cost/channel/subscriber (excluding equipment) that the industry incurs to provide service.[10]

2. The Commission should determine an industry-wide cost of capital and thereby determine an average cost/channel/subscriber for any cable system.[11]

3. Using these figures, the rate for any tier, regardless of its composition, can then be calculated. The Companies propose that if the system's rate is within 20% of that average, it would be presumptively reasonable.

4. To provide incentives to operators to upgrade facilities and services, the following factors should be added, on an annual basis, to form new average costs:

a. increases in programming costs

b. increases in maintenance costs

c. prorated charge for new construction

d. tax increases[12]

g. inflation factor (e.g. CPI)

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[10] This figure would include a component for depreciation and operating costs. The Commission could also categorize systems by other factors, such as size, and develop average costs for classes of systems.

[11] This could be done by analyzing capital costs of industries similar to cable or using the S&P400.

[12] This component would be in addition to any specific franchise related fees and expenses. In addition to on-going franchise fees and access support payments, some franchising authorities impose application fees and other periodic payment requirements.

Inclusion of these factors will encourage cable operators to continue expanding their capacity and adding new programming. Absent these incentives, the cable operator who is at or near the benchmark will be subjected to the pre-1984 political ratemaking in environment in which cost-justified rate increase requests often fell on deaf ears. While the Commission may offer the possibility of a safety valve appeal process to local rate decisions, that process will nonetheless be lengthy and costly. It can be avoided by adoption of this approach.

C. Equipment Charges

Section 623 contemplates that charges for equipment used for basic service must be based on actual costs. The Companies submit that the Commission should not interpret this provision to apply to equipment which is supplied solely for the purpose of enabling the subscriber to receive tier or premium programs and is used only incidentally for basic service. Under any other interpretation, there would be virtually no equipment that would not be subject to cost-based rate regulation because basic is required before a subscriber can purchase any other level of service. Only equipment that is operationally necessary to receive basic service would be subject to the actual cost limitations; equipment used for more than the basic tier should not be subject to this standard.

As noted in the NPRM, many operators do not charge the full cost of installation and equipment at the time of initial hook-up, a policy which promotes the availability of service to low-income consumers and helps to achieve a broader subscriber base. The Companies suggest a basket approach under which the equipment rate regulations do not focus on the charge for each piece of equipment individually but instead view individual charges in the context of the total charge for all basic equipment provided.

D. Procedural and Related Rate Regulation Issues

1. The Companies concur with the Commission's view expressed in the NPRM that it has no authority to assume regulation of basic rates if the franchising authority chooses not to seek certification; that conclusion comports with the clear intent of the House Report:

> The FCC may exercise regulatory authority with respect to basic cable rates only in those instances where a franchising authority's certification has been disapproved or revokes. . . [13]

2. Rate increase applications should be acted upon in 30 days as the Act requires and rates should be allowed to go into effect if no action is taken during the prescribed period. The Commission should hear all appeals from local rate decisions and cases involving potential roll-backs or refunds should be given expedited consideration so as to

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[13] H.R. Rep. No. 628, 102d Cong., 2d Sess. 81 (1992) (emphasis added).

avoid disruptive contingent liabilities for cable operators. Any required rate reductions should take place over the entire subscriber base and should be implemented in a manner that does not impair the cable system's ability to attract capital.

3. With regard to complaints filed with the Commission concerning tier rates, such complaints should be required to allege facts which if true would constitute a violation of the Act. Requiring complaints against tiered rates to be filed at the FCC within 30 days of the effective date of the rate change would be reasonable inasmuch as subscribers are typically given advance notice of any rate changes either by local regulatory requirements or as a matter of good business practice. Tier rate complaints should be dealt with in a single proceeding which minimizes the administrative burdens for the Commission and for the cable operator.

4. The Companies concur with the Commission's view expressed in paragraph 105 of the NPRM that challenges to existing tier rates are cut-off after 180 days from the effective date of the Commission's rules; there must be finality to the process and operators must be able to make financial plans for the future without open-ended exposure to potential financial liability. The Companies also seek clarification and confirmation that refunds would be limited to the period following the filing of a complaint as set forth in the Act.

5. Imposition of a uniform rate structure for each tier does not preclude cable operators from establishing bona fide categories with separate rates, terms and conditions and may, under some conditions, require cross-subsidization or rate averaging within that tier.[14]

6. As many parties observed in their comments in the tier buy-through proceeding, MM Docket 92-262, promotional offerings are in the public interest and should be permissible. The cable industry, typical of other suppliers of goods and services, offers discounts and other promotional arrangements to attract consumers; so long as such discounts are available to all consumers of the same class and category, they should be presumed to be reasonable and nondiscriminatory. Packaging and pricing of services other than basic and premium or pay-per-view, including buy-throughs of multiple tiers, are permissible under the Act and should be recognized by the Commission. Similarly, multi-pay discounts, so long as available to basic-only subscribers, on a nondiscrimination basis, should not be deemed objectionable.

II. Leased Channel Rates, Terms and Conditions

Section 9 of the 1992 Act amends Section 612 of the 1984 Cable Communications Policy Act (the "1984 Act"), which

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[14] For example, senior citizen discounts, seasonal rates and bulk and commercial rates should be permissible.

requires cable television operators to set aside channels for commercial leased access. Under the original statutory leased access formulation in the 1984 Act, rates, terms and conditions for leasing channels were set by the cable system operator, subject to statutory guidelines. The 1992 Act modifies this approach and authorizes the Commission to: (i) determine maximum reasonable rates for leased channels; and (ii) establish reasonable terms and conditions for channel use.

The needs of channel lessors vary widely and the resources and needs of cable system operators are equally diverse. Thus, it will be difficult, if not impossible, for the Commission to set a uniform maximum rate and standard terms and conditions that will be "reasonable" for every channel lease. Rather than establishing a fixed rate (or even benchmarks), the Commission should adopt a formula for identifying the permissible maximum. Further, the Commission should adopt guidelines for reasonable terms and conditions where needed, in lieu of attempting to develop standard channel lease provisions.

A. Because Section 612, Taken With Other Provisions of the Act, Poses Serious Constitutional Problems, Regulations Affecting Its Interpretation Should Be Drafted Narrowly.

When Congress required cable system operators to set aside certain channels for use by nonaffiliated programmers through both public, educational and governmental ("PEG") access and commercial leased access, the cable industry accepted the obligations as part of its public interest responsibilities despite the fundamental constitutional infirmities of those requirements. Recent amendments to both the "PEG" and commercial leased access provisions, as well as the adoption of mandatory carriage for broadcast stations[15], have severely circumscribed the operator's discretion over program content on system channels. As a result, the new statutory provisions are now being challenged in the courts.[16] In adopting rules to implement this provision, the Commission must be sensitive to the constitutional problems it poses and proceed as cautiously as possible.

B. Section 612, As Amended, Contemplates Leased Channel Availability on Terms that Are Reasonable but Still Remunerative to the Operator.

In adopting rules for leased access, the Commission must keep several guiding principles in mind. First and foremost, the type of access the provision affords is commercial

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[15] In addition to the section addressed in this Notice, Section 10 of the Act, restricts indecent programming on leased access channels. Section 10 also prohibits presentation of programming containing "obscene material, sexually explicit conduct, or material soliciting or promoting unlawful conduct on "PEG" channels." Furthermore, Sections 4 and 5 of the Act require the operator potentially to set aside more than one third of total capacity for mandatory carriage of local commercial and noncommercial television stations.

[16] See Time Warner Entertainment Company, L.P. v. FCC and United States, Civil Action No. 92-2494 (D.D.C. filed Nov. 5, 1992) and Discovery Channel v. United States, Civil Action No. 92-2558 (D.D.C. filed Nov. 13, 1992).

access. This provision was never intended to extend charity or to subsidize new business ventures. The Act does <u>not</u> require that channel leasing for commercial purposes be "free" or even "cheap."

The guidelines for leased channel rates in the 1984 Act stipulated that the operator must establish the price, terms and conditions of leased use "<u>at least sufficient</u> to assure that such use will not adversely affect the operation, <u>financial condition</u> or market development of the system." Section 612(c)(1). This language remains in the provision as amended in 1992. There can be no question that forcing an operator to relinquish up to 10% of valuable system channel capacity to leased users on non-remunerative, "give-away" terms and conditions will adversely affect the system's financial condition.

Nor is inexpensive channel time essential to encourage program diversity. Even assuming that the cable system will not provide sufficiently diverse fare on its own (which the Companies contend is <u>not</u> the case), the Act contains the above-mentioned "must-carry" and "PEG" access provisions to ensure that programming <u>not</u> selected by the system operator is carried by the system. In addition, in rules the Commission has yet to promulgate pursuant to Section 11 of the Act, cable operators affiliated through ownership with cable programming networks will be limited as to the number of channels they may fill with commonly-owned programming.

With all of these provisions, there is no need for non-remunerative leased access to achieve the desired goal of greater diversity.

C. The Commission Should Rely on Marketplace Regulation of Leased Channel Rates to the Greatest Extent Possible

In its NPRM, the Commission put forth a number of options for determining maximum leased channel rates. The Companies support the option of reliance on the marketplace whenever effective competition for leased channels exists. For purposes of leased channel rates, however, the test for "effective competition" must be different from the statute's effective competition test for subscriber rates. For purposes of subscriber rates, "effective competition" affords the subscriber a choice of comparable (i.e., multi-channel) sources for television programming. For leased channel competition, however, the programmer must have a choice of outlets for reaching the desired audience.

Accordingly, the definition of "effective competition" in the subscriber rate section of the Act, Section 623(l)(1), is not appropriate in the channel leasing context. The regulations should stipulate that "effective competition" for leased channels exists when another video distribution medium that is unaffiliated with the cable operator (whether multi-channel or single-channel) is capable of reaching the programmer's desired audience.[17]

D. In the Absence of a Competitive Market for Leased Channels, the Commission Should Establish a Formula for Determining the Maximum Rate.

The Companies do not support any of the other approaches set forth by the Commission. A benchmark approach, for instance, will not work for leased access because there is insufficient data on which to establish the benchmark. As noted in the Act's legislative history, the practice of channel leasing has been slow to develop.[18] Although the Companies all have engaged in channel leasing from time to time, they have received few, if any, requests to lease entire channels. Most channel lessees -- whether commercial ventures or non-profit organizations -- are part-time or "one time" users. Often, channel lessees appear to resort to leased access in an effort to secure a specific isolated time slot or the same daily or weekly slot, which might not be available due to "first-come-first-serve" scheduling that is

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[17] Not just cable television systems or other "multi-channel video distributors" as defined by the Act should be considered. The regulations also should take into account single-channel LPTV stations and MDS or OFS operations serving the desired audience and on which time is available to programmers; commercial time is also available on full-power television stations.

[18] S. Rep. No. 92, 102d Cong., 1st Sess. 30 (1991). The Companies contend that the failure of leased access to develop is the result of the tremendous financial commitment and risk entailed in establishing a successful programming service rather than the result of imposition of unreasonable terms and conditions for channel use by cable operators.

prevalent on PEG channels. Although a few programmer/lessees do live productions, most provide programming on tape for the operator to insert on the channel. Some deliver taped programming to the system headend via direct line or microwave feed. Given the relatively modest amount of channel leasing and the tremendous differences among the arrangements that do exist, there is no pattern of use or body of data on which the Commission could reasonably rely in establishing a benchmark.

The other approaches considered by the Commission are equally unsatisfactory because they ignore a key factor in determining whether the channel lease will "adversely affect" the financial condition of the system -- the value of the channel to the operator. Each channel on a cable system represents an opportunity for the operator to produce revenues. When an operator loses the right to program a channel, it may lose the possibility of generating revenue from that channel directly, for example, through subscription fees, sale of advertising or use for periodic pay-per-view events. (The operator also may lose the right to generate revenue indirectly, through satisfaction of existing subscribers and attraction of new subscribers.) The Act permits a channel's revenue-producing capacity to be considered in setting a lease rate. The Companies offer two approaches that take channel value into account:

1. Cost-of-Service:

No approach will work unless it takes into account the differences in channel use. One way to accomplish this result is a cost-of-service approach tailored to the individual system and programmer in question, with realization by the operator of a reasonable profit or "cost of capital" as the means for recognizing channel value.

2. Channel Value Approach Based on Implicit Charge Formula:

In 1982 two prominent economists with considerable cable industry expertise conducted a study for the Rand Corporation, entitled An Economic Analysis of Mandatory Leased Channel Access for Cable Television.[19] They defined an implicit channel charge that recognizes the revenue-producing capacity or value of a cable channel. Specifically, they formulated

$$AC = (R + A) - (F + E)$$

The terms in the formula are as follows:

AC = Implicit Channel Access Charge

R = Subscriber Revenue Per Channel

F = Fees Paid to Programmers

E = Direct Expenses for Billing and Marketing

A = Advertising Revenue

[19] See Besen and Johnson, The Rand Corporation, December, 1982, prepared under a grant from the John & Mary R. Markle Foundation.